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January 4, 1995



**HAND DELIVERED**

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

**Re: Cable Rate Regulation MM Docket Nos. 92-266, 93-215**

Dear Mr. Caton:

Enclosed please find an original and two copies of a Petition for Reconsideration of the Sixth Order on Reconsideration and Fifth Report and Order in the above-referenced proceeding (FCC 94-286, 59 FR 62614, Release November 18, 1994).

We are also delivering a copy of the Petition for Reconsideration to each Commissioner, two copies to the Cable Services Bureau, and one copy to the information office, pursuant to Section 1.419 of the Commission's rules.

If you have any questions, comments, or concerns regarding this matter, please contact the undersigned.

Respectfully submitted,

VARNUM, RIDDERING, SCHMIDT & HOWLETT

Patrick A. Miles, Jr.

PM/pll
Enclosure

**Before the**
**FEDERAL COMMUNICATIONS COMMISSION**
**Washington, D.C. 20554**



In the matter of:

| | | |
|---|---|---|
| IMPLEMENTATION OF SECTIONS OF THE CABLE TELEVISION CONSUMER PROTECTION AND COMPETITION ACT OF 1992: RATE REGULATION | ) ) ) ) ) ) | MM Docket No. 92-266 MM Docket No. 93-215 |

**TO THE COMMISSION:**



## PETITION FOR RECONSIDERATION

### I. Introduction

Pursuant to Sections 1.414 and 1.419 of the Commission's rules and the Sixth Order on Reconsideration, Fifth Report and Order, and Seventh Notice of Proposed Rulemaking, MM Docket 92-266, 59 FR 62614, FCC 94-286 ("Sixth Recon. Order" or "Fifth Report" or "Seventh Notice") (1994), the City of St. Joseph and Benton Charter Township ("West Michigan Communities"), respectfully submit comments and a petition for reconsideration to encourage the Commission to amend its rule regarding the offset of programming cost increases by the revenues cable operators receive from one or more programmers. West Michigan Communities favor a tier-based adjustment in accordance with the intent and plain language of the Cable Television Consumer Protection and Competition Act of 1992 (the "Cable Act" or "1992 Cable Act"), instead of the channel-by-channel approach the Commission recently adopted.

## II. Background

The revenue adjustment rule is set forth in Section 76.922(d)(3)(x) of the Commission's Rules. Previously, Section 76.922 read as follows:

> "Adjustments to permitted charges on account of increases in costs of programming shall be further adjusted to reflect any revenues received by the operator from the programmer." 47 C.F.R. § 76.922(d)(3)(x) (1995).

The Commission amended Section 76.922(d)(3)(x) in the Fifth Order. See Fifth Order, at ¶ 74. The amendment added the following sentence: "Such adjustments shall apply on a channel-by-channel basis." 47 C.F.R. § 76.922(d)(3)(x) (1993).

West Michigan Communities respectfully submit that the Commission erred in adding the above sentence to Section 76.922(d)(3)(x). The 1992 Cable Act and its legislative history expressly contemplate a tier-based approach to the offsetting of programming cost increases on the basic service against revenues cable operators receive from programmers. 47 U.S.C. § 543(b)(2)(C)(iv); H.R. Conf. Rep. No. 102-862, 102nd Cong., 2nd Sess. 65 (September 14, 1992). Moreover, a tier-based adjustment gives cable operators an incentive to add diverse programming and increase subscriber choice. In contrast, a channel-by-channel adjustment creates a preference for the addition of no cost or pay for carriage programming. Because no cost and pay for carriage channels generally do not have associated acquisition costs, cable operators can add such channels, charge a higher maximum permitted rate, and avoid any offset of the revenues received from the programmers.

To prevent such practices, the Commission's rules, statements, and forms (and instructions) initially comported with the tier-based approach. See Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, MM Docket No. 92-266, 8 FCC Rcd. 5631, FCC 93-177 ("Report and Order")

(May 3, 1993), at ¶ 253 and n. 602; see also Instructions to FCC Form 1210, Page 9, Line B1a.

Without any notice or comments from interested parties, however, the Commission's Fifth Order modified this adjustment rule to the detriment of cable subscribers by adopting a channel-by-channel offset.

West Michigan Communities respectfully request that the Commission (1) reconsider its amendment of Section 76.922(d)(3)(x) and (2) unambiguously rule that all revenues cable operators receive from basic (and cable programming services) tier programmers offset programming cost increases on such tier.

## III. Interest of West Michigan Communities

West Michigan Communities have a distinct interest in the Commission's abrupt reversal of the offset rule. The experience of West Michigan Communities provides a clear example of the negative effects of permitting a channel-by-channel adjustment (instead of a tier-based adjustment).

Specifically, the cable operator serving the West Michigan Communities,[1] among others, added approximately 20 channels which it receives effectively free (and dropped four channels which had acquisition costs) in August 1993. The 20 channels the operator added included the following eight home shopping channels: QVC, Home Shopping Network 2, QVC Fashion, Shop at Home, Cable Marketplace, Video Catalog I, Valuevision, and Video Catalog II. Prior to the onset of regulation, there was only one home shopping channel. In addition, the operator added channels such as Showcase, VISN/Acts, The Outdoor

[1]West Michigan Communities are certified to regulate basic tier rates and associated equipment pursuant to Section 76.910 of the Commission's Rules.

Channel, The Box, Z Music, The Travel Channel, C-SPAN II, EWTN, TBN, MOR Music, The Food Network, National Empowerment Channel, New Inspiration TV, Keystone Inspiration, and Dr. Gene Scott channels which, on information and belief, the cable operator obtains at no cost. In fact, some of these channels (such as the nine home shopping channels, among others), pay the cable operator for carriage on the system.

The cable operator added such no cost channels and pay for carriage channels for a simple reason: to increase its revenues without increasing its costs. The operator raised the number of channels times which its maximum permitted per channel rate is multiplied. But, the operator's costs did not increase because the channels it added are available at no cost. Some of the programmers pay the operator consideration for carriage on the system -- an additional bonus to the operator. Subscribers do not receive any benefit from the consideration the programmers pay the operator under a channel-by-channel adjustment.

## IV. A Tier-Based Adjustment Is Sound Policy

A tier-based adjustment removes the incentive a channel-by-channel offset gives cable operators to add no cost or pay for carriage programming instead of programming with acquisition costs. That is, if revenues from pay for carriage programmers are used to offset increases in costs from other programming on the tier, then operators do not have an incentive to add pay for carriage programming to the exclusion of programming with acquisition costs and to the detriment of subscriber choice. Moreover, under a tier-based approach subscribers obtain, in part, the benefits from revenues the cable operator receives from pay for carriage programmers. Increases in a cable operator's programming costs (which are generally passed on to subscribers) should be offset by revenues the operator receives from other programmers on the tier.

A channel-by-channel adjustment allows cable operators to add no cost and pay for carriage programming without any offset of programming cost increases. In most, if not all, cases, cable operators do not have programming costs for channels from which they receive revenues. Because pay for carriage programmers generally do not have associated costs, the channel-by-channel offset rule is meaningless.

A tier-based revenue offset rule is necessary to keep basic cable service rates low and to permit cable operators from "double dipping." A channel-by-channel offset allows cable operators to "double dip" at the expense of subscribers by (1) adding no cost or pay for carriage programming, (2) charging subscribers for such channels (thereby increasing regulated rates by charging the maximum permitted rates for each such channel) while at the same time (3) not offsetting such revenues against cost increases on the basic service tier.

A tier-based analysis is appropriate and logical. Subscribers receive the benefit the 1992 Cable Act intended when cable operators offset revenues from programmers against programming cost increases (which are passed on to subscribers).

## V. The 1992 Cable Act Requires A Tier-Based Adjustment

Section 623 of the 1992 Cable Act clearly contemplates that revenues and consideration from programming on the basic service tier or "obtained in connection with the basic service tier" be used to offset cost increases. 47 U.S.C. § 543(b)(2)(C)(iv). Section 623 provides, in part, that the Commission "shall take into account . . . revenues (if any), received by a cable operator from advertising from programming that is carried as part of the basic service tier or from other consideration obtained in connection with the basic service tier." Id. Section 623 of the Cable Act thus suggests a broad approach to the

examination of revenues cable operators receive "in connection with the basic service tier." See id. [emphasis added].

The Congressional Conference Report in the 1992 Cable Act's legislative history states that the purpose for this provision in the Cable Act was a "clarification . . . intended to keep the rates for basic cable service low." H.R.Conf.Rep. No. 102-862, 102nd Cong., 2nd Sess. 63 (September 14, 1992). The Conference Report provides further that "[t]he Commission is authorized to examine other consideration, in addition to advertising revenues, received by the cable operator in connection with providing cable programming services." H.R. Conf. Rep. No. 102-862, 102nd Cong., 2nd Sess. 65 (September 14, 1992).

In accordance with Section 623, the Commission stated in its May 3, 1993 Report and Order: "The Cable Act of 1992 requires that regulations governing rates for the basic service tier take into account cable operator revenues from advertising on the basic service tier or other consideration obtained in connection with the basic tier." Report and Order, at ¶ 253 and n. 602 [emphasis added]. The Commission correctly interpreted Section 623 to require that cable operator revenues from programmers be adjusted on a tier basis rather than on a channel-by-channel basis.

The Commission stated that Section 623(b)(2)(C) of the 1992 Act necessitates that it "require any revenues received by an operator, or shared by the programmer and the operator, for carriage of signals be netted against costs for purposes of calculating whether there has been an increase or decrease in programming costs for the programmer. We believe this most equitably balances the interests of cable operators in being compensated for increases in programming costs and of subscribers in paying fair rates. Thus, cable operators may recover increased costs of programming from subscribers but not to the

extent they receive revenue from a programmer on account of carriage of programming." Id. Even if one programmer is compensating the operator, the rule requires that revenues be used to offset increased costs of programming on the entire tier.

As originally adopted, Section 76.922(d)(3)(x) of the Commission's rules unambiguously required a tier-based adjustment to the maximum permitted rates (which are tier-based as well):

> "Adjustments to permitted charges on account of increases in costs of programming shall be further adjusted to reflect any revenues received by the operator from the programmer." 47 C.F.R. § 76.922(d)(3)(x) (1993).

The Report and Order accompanying the Commission's original rules states: "The precise methodology for calculating external program costs and allocating them to the appropriate tiers will be set forth in FCC forms." Report and Order, at ¶ 253. Accordingly, the instructions to FCC Form 1210, Line B1a state: "Net programming costs are . . . programming costs less any payments by programmers to [operators]. For example, cash incentives, refunds, rebates, or other payments from programmers to [an operator] in connection with the sale of programming services must be subtracted from the figure [an operator] put[s] on this line." Instructions to FCC Form 1210, Page 9, Line B1a.

The instructions expressly use the plural "programmers," and do not contain any reference to a channel-by-channel computation. Further, maximum permitted rates and going forward adjustments on the Form 1210 are tier-based.

## VI. The Commission's Abrupt Reversal Was Inappropriate

In the Fifth Report and Order, the Commission apparently modified its rule in Section 76.922(d)(3)(x) by adding the sentence: "Such adjustments shall apply on a channel-

by-channel basis." 47 C.F.R. §76.922(d)(3)(x) (1995). The text of paragraph 74 of the Fifth Order which accompanies the amendment to Section 76.922(d)(3)(x) reads as follows:

> In the Rate Order, we provided that any revenues received from a programmer, or shared by a programmer and an operator, must be netted against costs for purposes of calculating whether there has been an increase or decrease in external costs. We extend this requirement for offsetting revenues against costs to the per channel adjustment factor for channels added to CPSTs pursuant to our revised channel adjustment rules. The revenues must be deducted from programming costs and then, to the extent revenues are remaining, from the per channel adjustment. Offsetting will apply on a channel-by-channel basis. We believe that this best balances the interest of the cable operator in being compensated for adding new programming in the interest of subscribers in receiving reasonable rates."

Fifth Order, at ¶ 74. West Michigan Communities disagree with the Commission's conclusion and amendment of Section 76.933(d)(3)(x). West Michigan Communities and other interested parties were not given any notice or opportunity to comment on a change in Section 76.922(d)(3)(x) of the Commission's rules.[2] Had the Commission intended to reverse its rule, it should have engaged in notice rulemaking. Because it did not, the Commission did not receive complete, factual and legal arguments against changing the well-founded tier-based analysis.

Under the Fifth Amendment to the United States Constitution and the Administrative Procedures Act, 5 U.S.C. § 553, the Commission should not have changed its rule in Section 76.922 without giving affected persons such as West Michigan

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[2]The Cable Services Bureau did respond to the inquiries of three programmers by issuing three letters concerning the offset rule. See Letter from Cable Services Bureau Chief to QVC Networks, Inc., dated May 6, 1994, Letter from Cable Services Bureau Chief to The Home Shopping Network, dated May 6, 1994, and Letter from Cable Services Bureau Chief to MTV Networks, dated August 2, 1994. The letters set forth a channel-by-channel application of Section 76.922(d)(3)(x) to these programmers. No comments from interested parties were solicited by the Cable Services Bureau prior to the release of its response to the three programmers.

Communities notice and an opportunity to comment on the change in the Commission's rules under that principle. See National Family Planning v. Sullivan, 979 F.2d 227, 240 (D.C. Cir. 1992); Boston Edison Company v. FPC, 557 F.2d 845, 849 (D.C. Cir. 1977); cert. denied, 434 U.S. 956 (1977); Homemakers North Shore, Inc. v. Bowen, 832 F.2d 408, 412 (7th Cir. 1987).

The Commission should correct this error and reconsider its amendment of Section 76.922(d)(3)(x).

**VIII. Conclusion**

West Michigan Communities respectfully suggest that the Commission's new channel-by-channel adjustment does not comport with the 1992 Cable Act, and creates an incentive to cable operators to add pay for carriage programming to the detriment of programming with acquisition costs and to the detriment of subscriber choice. A channel-by-channel adjustment stifles the addition of new, diverse programming.

The Commission should reconsider its channel-by-channel adjustment and rule that such adjustments be made on a tier basis.

Respectfully submitted,

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Dated: January 4, 1995

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